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TAGS: ECON EFIN PREL TU
SUBJECT: TURKEY'S ECONOMY: CONCERN WITH GOT INDECISIVENESS

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¶1. (SBU) Summary: IMF resident rep briefed us on the results of the ten-day IMF mission which finished December 20. The IMF is concerned with the new GOT's slowness in taking decisions - it has not yet committed to the 6.5 percent of GNP primary budget surplus for 2003 (and the first quarter 2003 budget came in over $1 billion short of that target); different ministers have issued contradictory statements on implementing a key piece of reform legislation (the public procurement law); there has been no progress on outstanding banking sector measures. The IMF Mission will return in early January to finalize the Fourth Review and push for meeting these and other outstanding conditions. A big part of this slowness on the economic reform front is owing to the new government's overwhelming agenda of urgent issues, rather than to ill intentions. But sharp market declines this week may serve to energize the new GOT on the IMF program agenda. End Summary.

"Lots of Work to Be Done"

¶2. (SBU) An IMF mission was in Ankara December 10-20 to review progress on meeting outstanding conditions under the Fourth Review, and to work with the GOT on the 2003 budget. IMF resrep gave us a brief readout December 20 as he was heading into the wrap-up sessions with GOT. He concluded that there's lots of work to be done, especially on budget and several structural issues. Monetary policy is not a major problem for the moment.

Fiscal Policy

¶3. (SBU) Provisional Budget. The parliament must pass a budget before year-end to keep the GOT functioning, and the government submitted to parliament on December 19 an interim budget to cover the first quarter (in January it will submit a full-year 2003 budget). IMF resrep said this first quarter budget falls short of meeting the 6.5 percent of GNP primary surplus target: it targets a TL 3.2 quadrillion primary surplus, versus the TL 5 quadrillion that the IMF would prefer.

¶4. (SBU) Resrep said the IMF understood the GOT was under time pressure to pass a budget but that the result was not good. The GOT was looking at taking some measures in the first quarter (increasing employers' social security premiums, cutting health spending) to make up some of the shortfall.

-- Comment: The first quarter primary surplus shortfall (over $1 billion) is a problem for two reasons. First, the primary surplus is used to help meet immediate debt service payments, so the shortfall could become a financing issue. At the minimum, it involves borrowing more in the first quarter than initially anticipated. Second, this first quarter shortfall, together with the approximately $1.5 billion shortfall in the 2002 primary surplus, puts the GOT further behind in meeting year-end 2003 budgetary goals - again this has GOT financing implications.

¶5. (SBU) Primary Surplus. Resrep said the GOT has yet to commit to a 6.5 percent of GNP primary surplus for 2003. Deputy PM Sener said in private meetings, and again on December 18 to the press, that the GOT would support a 6.5 percent target, but in a subsequent meeting, PM Gul told the IMF Mission Chief that the GOT had not yet decided.

¶6. (SBU) Tax and Public Sector Reforms. Resrep said the IMF can live with the tax package passed by parliament December ¶19. It included cancellation of the Financial Year Zero Law (ref a), extension of a temporary earthquake tax, extension of the tax exemption for income from T-bills (a Dervis initiative), and a lump sum transfer of income from the independent regulatory boards o the central government budget. Resrep commented that canceling the Financial Year Zero law (a law intended to boost tax compliance) would make meeting tax revenue goals more difficult, but by itself was not a deal-breaker.

-- The new government's second tax measure - a tax amnesty on unpaid back taxes - was, per IMF resrep, a deal-breaker. The problem was that this amnesty was part of AK's election platform and the party was committed to it. The IMF is working with the Finance Ministry to come up with some form of amnesty that meets the ruling party's need, while not damaging the GOT's ability to collect taxes (perhaps re-scheduling back tax payments, or lessening some of the accrued penalties for late payments).

-- There has been no progress on meeting other Public Sector reform conditions. The IMF has not yet seen a draft of the proposed direct tax reform legislation. The end October condition of reducing redundant public sector jobs by 30,500 is still about 10,000 jobs short.

Structural Reforms

¶7. (SBU) Public Procurement Law implementation. The GOT has issued conflicting statements on this issue, as on the primary surplus issue. Deputy PM Sener announced after the December 18 Council of Ministers meeting that it would be implemented on schedule January 1. However, shortly thereafter the Public Works Minister Zeki Ergezen said there needed to be at least a six-month delay for technical reasons. The IMF still didn't know where this issue stood, though the IMF, World Bank and EU Commission were united that this law needed to be implemented on time.

-- Comment: There may be technical reasons for delaying implementation of the law - and we heard from the Privatization Administration that they don't want their consultancy contracts to be subject to the law - but the IMF, World Bank and EU are not convinced. Nor are we. Local construction firms are lobbying the GOT for the delay (just as they lobbied against passage of the law last January), because they don't like new rules that allow more transparency and foreign competition in public procurement. End Comment.

¶8. (SBU) Banking Sector. There has been no progress on two outstanding Fourth Review conditions: (i) BRSA resolution of PamukBank and control of Yapi Kredi Bank (ref b); (ii) sale of an initial $250 million in assets from bankrupt banks now owned by BRSA. IMF resrep said IMF staff would not take the Fourth Review to the IMF Board before the Pamuk, Yapi Kredi issues were resolved. He said BRSA staff were balking at selling bankrupt bank assets, because they knew they would only get 7-8 percent of face value of these assets (mainly non-performing loans) and were afraid of public criticism for selling on the cheap.

-- Comment: There is some urgency on the Yapi Kredi problem, since the bank's equity is deteriorating rapidly. IMF resrep confirmed that this large bank is now under the 8 percent capital adequacy ratio. BRSA Chairman Akcakoca separately told us he is continuing to negotiate over Pamuk with former owner Mr. Karamehment of the Cukurova Group; they haven't gotten close on the larger Yapi Kredi issues. Karamehmet wants BRSA to return Pamuk to him with the $2 billion injected by the BRSA. BRSA cannot do that legally. Akcakoca said he would appreciate a strong statement of support from the Government, which has not yet been forthcoming.

¶9. Privatization. Resrep said the government "hasn't yet come to grips with privatization." The IMF had approved the draft privatization plan for alcohol and tobacco monopoly TEKEL; the ministerial level Higher Privatization Council must adopt this plan as part of the Fourth Review.

-- Privatization Administration Chairman Bozkurt separately confirmed to us this lack of attention to date on

privatization. Bozkurt said he is ready to proceed with privatizing TEKEL, state petrochemical giant PETKIM and several other major projects, but needs political level approval. Furthermore, in October and early November he auctioned off a series of smaller state companies, and is sitting on successful bids amounting to about $200 million. He is awaiting GOT approval to announce these sales. Bozkurt's agency comes under Deputy PM Sener, who has asked Bozkurt for the names of the members of state company boards of directors under the PA (there are 257 positions). Bozkurt understands Sener is under some pressure to give jobs to AK supporters, but "first let him do approve some privatization."

Comment on Market Reaction

¶10. (SBU) The new government's honeymoon in the financial markets has ended, though not solely or even mainly because of the economic reform issues discussed above. Local markets dropped sharply this week - the lira depreciated about 7 percent; the stock market lost 14 percent; rates on lira-denominated Treasury bills rose by 5 percentage points. But analysts tell us this was mostly driven by concerns over Iraq. News on lack of progress on economic reforms will further depress the markets here; conversely, good news on this front would help offset the Iraq concerns in the markets.

¶11. (SBU) The IMF Mission plans to return in early January to continue the Fourth Review and focus on the full year budget. A major part of the new GOT's slowness on economic reforms appears related to its overwhelming agenda rather than ill intentions. But this week's market reactions may serve as a wake-up call. The AK party leadership may have grown a bit complacent on the econ front after the big rallies following their election in November.
PEARSON